

## Message Text

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C O N F I D E N T I A L SECTION 01 OF 03 PARIS 06120

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WHITE HOUSE PASS CEA CHAIRMAN SCHULTZE AND SHAFER

PASS TREASURY FOR WIDMAN; FEDERAL RESERVE FOR ETTIN

DEPARTMENT FOR EUR/RPE

E.O. 11652: GDS  
TAGS: ECON, OECD  
SUBJECT: ECONOMIC POLICY COMMITTEE, FEBRUARY 27-28  
(AND RESTRICTED BUREAU FEBRUARY 27): ISSUES AND SCENARIO

REFERENCES: (A) AGENDA (CPE/A(78)1); (B) MAIN ISSUES  
(CPE(78)4); (C) POLICY-MAKING CONSTRAINTS AND POS-  
SIBILITIES (CPE(78)2); (D) ECONOMIC PROSPECTS  
(CPE(78)3)

1. SUMMARY: FEBRUARY 27-28 EPC WILL ADDRESS ISSUES OF  
OECD GROWTH AND REAL OR PERCEIVED CONSTRAINTS TO STIMU-  
LATIVE POLICIES IN CONTEXT OF THE RECENT ATTACKS ON THE  
"LOCOMOTIVE THEORY." THE SECRETARIAT DOCUMENTATION FOR  
EPC DISCUSSING CONSTRAINTS TO GROWTH AND QUANTIFYING  
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EXAMPLES OF MUTUAL REINFORCEMENT THROUGH THE INTER-  
NATIONAL TRANSMISSION MECHANISM SUGGESTS A BASIS FOR  
REPLACING LOCOMOTIVE CONCEPT WITH A COORDINATED, BUT  
STILL DIFFERENTIATED, AREA-WIDE APPROACH TO OVERCOME  
THE VARIOUS CONSTRAINTS FACED BY INDIVIDUAL COUNTRIES  
TO REACH A MORE SATISFACTORY GROWTH RATE BY EARLY 1979.  
THIS MESSAGE SUMMARIZES THE HIGHLIGHTS OF THE ISSUES

FOR DISCUSSION AS WELL AS THE SECRETARIAT'S SUGGESTION FOR THE SCENARIO FOR THE MEETING AND ITS THINKING ON THE EPC CONCLUSIONS, BOTH FOR PRIVATE AND PUBLIC CONSUMPTION. CEA CHAIRMAN SCHULTZE WILL BE ELECTED EPC CHAIRMAN AT THE BEGINNING OF THIS MEETING. END SUMMARY

2. ISSUES: THE SECRETARIAT'S "MAIN ISSUES" PAPER (REFDOC B) FOR THIS EPC, THE "MINI-EPC" DESIGNED TO FOCUS ON POLICY ISSUES RATHER THAN ON MAJOR REASSESSMENT OF THE ECONOMIC SITUATION (WHICH TAKES PLACE AT AUTUMN AND SPRING MEETINGS OF EPC), POSES FOUR MAJOR ISSUES:

(1) IS ACCELERATION OF AREA-WIDE GROWTH TO REACH 5 PERCENT ANNUAL RATE AT END OF THE NEXT 12 MONTHS (BY EARLY 1979) DESIRABLE AND FEASIBLE WITHOUT SPARKING A NEW ROUND OF EXCESSIVE INFLATION?

(2) DOES SUCH AN ACCELERATION REQUIRE COORDINATED DIFFERENTIAL DEMAND MANAGEMENT SO AS TO OVERCOME THE UNEVEN PATTERN OF INFLATION AND BALANCE-OF-PAYMENTS CONSTRAINTS? IN THIS CONTEXT, WHAT IS THE ROLE OF THE COUNTRIES IN STRONGER BALANCE-OF-PAYMENTS POSITION?

(3) WHAT ARE THE MAJOR CONSTRAINTS PERCEIVED BY  
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INDIVIDUAL MEMBER COUNTRIES AND HOW CAN POLICIES BE TAILORED TO OVERCOME THESE CONSTRAINTS WHILE CONTRIBUTING TO AREA-WIDE FASTER GROWTH?

(4) TO WHAT EXTENT HAS SLOW GROWTH MULTIPLIED THE NUMBER AND SCOPE OF GOVERNMENT INTERVENTIONS IN THE MEMBER ECONOMIES? HOW CAN JOINT ACTION ASSURE THAT SUCH MEASURES ARE TEMPORARY AND ENHANCE NECESSARY STRUCTURAL ADJUSTMENT, RATHER THAN PERMANENTLY CONTRIBUTE TO GREATER RIGIDITY AND INEFFICIENCY IN THE MEMBER ECONOMIES?

3. SECRETARIAT DOCUMENTATION BRIEFLY REVIEWS THE NATIONAL OBJECTIVES AS MODIFIED SINCE THE NOVEMBER EPC, CONCLUDING THAT THE AREA-WIDE PICTURE HAS CHANGED LITTLE SINCE WEAKER OUTLOOK IN GERMANY HAS BEEN COUNTERBALANCED BY HIGHER TARGET IN JAPAN. THE FORECASTS SHOW A SIMILAR INTERNAL REARRANGEMENT WITH LITTLE AGGREGATE CHANGE.

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4. THE MAJOR SECRETARIAT EFFORT IS AN ATTEMPT TO CLARIFY, AND TO SOME EXTENT MODIFY, THE GENERAL UNDERSTANDING (BOTH WITHIN THE EPC AND BY THE PUBLIC) OF THE "LOCOMOTIVE" THEORY. FIRST, REFDOC C IDENTIFIES SEVERAL OF THE PRINCIPAL CONSTRAINTS (INFLATION, SLUGGISHNESS OF INVESTMENT, EXTERNAL IMBALANCES AND SECTORAL DISPARITIES) NOW FACING POLICY-MAKERS. IT SUGGESTS THAT ANY ONE COUNTRY WOULD BE FACED BY A UNIQUE MIX OF THESE CONSTRAINTS, REQUIRING INDIVIDUALLY-TAILORED POLICY MEASURES. THE SECRETARIAT ARGUES THAT THE VARIOUS CONSTRAINTS CAN BE VERY SUBSTANTIALLY REDUCED THROUGH A GENERAL IMPROVEMENT IN THE EXTERNAL ENVIRONMENT IN WHICH COUNTRIES FIND THEMSELVES. THIS REINFORCES THE DESIRABILITY OF A COORDINATED, RELIABLE POLICY PROGRAM THROUGHOUT THE OECD AREA. SECOND, THE SECRETARIAT (IN REFDOC D, TABLE 3) PRESENTS ECONOMETRIC RESULTS OF TWO SIMULATIONS PORTRAYING THE EXTENT OF BENEFICIAL AREA-WIDE EXPANSION GENERATED BY A SMALL POLICY-INDUCED EXPANSION IN (A) FIVE STRONG BOP COUNTRIES AND (B) IN SOME OTHER COUNTRIES TO THE EXTENT OF  
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ABSORBING THE BENEFICIAL BALANCE OF PAYMENTS EFFECT OF

EXPANSION IN THE STRONG FIVE. THESE ILLUSTRATIONS DO NOT RELY ON DIRECT TRANSMISSION OF GROWTH IMPULSES, BUT RATHER ON THE SALUTORY EFFECT OF THE INITIAL IMPETUS IN EASING THE CONSTRAINTS FELT BY OTHERS, THUS PERMITTING SOME EXPANSIONARY POLICY MEASURES IN THE INTERMEDIATE AND EVEN THE WEAK ECONOMIES. THIS DOCUMENTATION, TOGETHER WITH A DISCUSSION DIRECTED AT THE ISSUES OF CONSTRAINTS AND HOW TO OVERCOME THEM, COULD LEAD TO A USEFUL CLARIFICATION OF THE "LOCOMOTIVE" THEORY. IN FACT, IT MAY LEAD TO ABANDONMENT OF THE LOCOMOTIVE CONCEPT IN FAVOR OF SOMETHING WHICH BETTER REFLECTS THE IDEA OF GENERALIZED BUT DIFFERENTIATED EXPANSION AS INDIVIDUAL COUNTRY CONSTRAINTS ARE EASED BY THE ACTION OF OTHERS; SUPPLEMENTED BY THE NOTION THAT ADDITIONAL BENEFITS ALSO ACCRUE TO THE STRONG (HISTORICALLY EXPORT-LED) ECONOMIES FROM A GENERALIZED EXPANSION IN THE AREA. (UNTIL A BETTER TERM IS INVENTED, THE NEW CONCEPT IS BEING REFERRED TO IN THE OECD CORRIDORS AS THE "COORDINATED REFLATIONARY ACTION PROGRAM" -- C.R.A.P.)

5. WORKING PARTY 3 (FEBRUARY 16-17) ADDRESSED SIMILAR QUESTIONS FROM THE BALANCE-OF-PAYMENTS POINT-OF-VIEW AND CONCLUDED THAT CONTRADICTIONS IN THE PRESENT SITUATION, PARTICULARLY REGARDING THE EXCHANGE MARKET DISRUPTIONS CREATED BY EXCESSIVELY DIFFERENTIATED GROWTH, THE DESIRE TO MAINTAIN HIGH GROWTH IN THE U.S., AND THE INABILITY OF STRONG EUROPEAN COUNTRIES TO RAPIDLY CLOSE THE GAP NECESSITATE A COORDINATED APPROACH TO MACRO POLICY AND EXCHANGE RATE POLICY TO PREVENT UNSUSTAINABLE PAYMENTS IMBALANCES ON THE ONE HAND, OR UNACCEPTABLY HIGH UNEMPLOYMENT ON THE OTHER. FULL TEXT OF WP-3 CHAIRMAN'S SUMMARY REPORTED SEPTEL.  
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6. THE STRUCTURAL ADJUSTMENT ISSUE IS ADDRESSED ONLY PERIPHERALLY IN THE DOCUMENTS PREPARED FOR THIS MEETING, RELYING HEAVILY ON CE(78)1 PREPARED FOR XCSS IN JANUARY. ALTHOUGH PHRASED IN TERMS OF THE DANGERS OF PROTECTIONISM AND THE SCOPE FOR CONTROLLING IT, THE EPC DISCUSSION OF STRUCTURAL ADJUSTMENT QUESTIONS IS EXPECTED TO FOCUS ON THE EFFICIENCY ASPECTS OF DIRECT AND INDIRECT PROTECTIONIST MEASURES, PARTICULARLY EMPLOYMENT AND INDUSTRY SUBSIDIES. THE SECRETARIAT IS BASICALLY LOOKING FOR AN ENDORSEMENT BY THE EPC OF THE VIEW THAT GREATER PROLIFERATION OF SUBSIDIES AND OTHER GOVERNMENT INTERVENTIONS IN THE ECONOMY MAY LEAD TO REDUCED EFFICIENCY AND GREATER RIGIDITY, THUS AFFECTING GROWTH POTENTIAL AND CAPACITY FOR FUTURE ADJUSTMENT.

7. SCENARIO: AS GIVEN IN MORE DETAIL IN PAPER HAND-CARRIED TO WASHINGTON BY SHAFER (CEA), GELBARD (EUR/RPE) AND KLOCK (TREASURY), THE SECRETARIAT HAS SUGGESTED THE FOLLOWING MANNER FOR CONDUCTING EPC MEETING: DISCUSSION WOULD BE ORGANIZED IN TWO BLOCKS, WITH ALL OF THE FIRST DAY (MONDAY) DEVOTED TO ISSUES (1) - (3) IN PARAGRAPH 2 ABOVE, FOLLOWED BY A CHAIRMAN'S SUMMARY OF THAT DISCUSSION TO OPEN THE SECOND DAY. COMMENTS ON THE CHAIRMAN'S SUMMARY WOULD END MID-MORNING (TUESDAY) TO ALLOW AT LEAST TWO HOURS FOR DISCUSSION OF THE STRUCTURAL ISSUE

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(4) IN PARAGRAPH 2 ABOVE, WHICH WOULD BE CONTINUED DURING THE SECRETARY-GENERAL'S LUNCH ON TUESDAY. GIVEN THE EXTENT OF THE DISCUSSION AT THE NOVEMBER EPC CONCERNING THE DESIRABILITY OF FASTER GROWTH AND THE REDUCED RISK OF A NEW INFLATIONARY SPIRAL, THE SECRETARIAT BELIEVES IT DESIRABLE TO ASK DELEGATES TO FOCUS ON CONSTRAINTS TO GROWTH AND THE "NEW" INTERPRETATION OF THE COORDINATED GROWTH STRATEGY RATHER THAN REHEARSING ONCE AGAIN THE OUTLOOK FOR INDIVIDUAL COUNTRY PERFORMANCE. THIS FORMAT WOULD HELP TO AVOID STERILE POLEMICS, BUT RATHER WOULD ENCOURAGE A GENUINE CONSULTATION AND EXCHANGE OF VIEWS ON THE UNDERLYING ISSUES AND INTERRELATIONSHIPS. THE SECRETARIAT (FAY) DOES NOT PLAN AN OPENING STATEMENT, BUT HOPES THAT CHAIRMAN

SCHULTZE WILL, IN HIS INTRODUCTORY REMARKS, SET STAGE FOR FOCUSING THE DISCUSSION AS OUTLINED ABOVE.

8. POSSIBLE CONCLUSIONS: FOR THE CHAIRMAN'S PUBLIC SUMMARY, THE SECRETARIAT BELIEVES THAT IT WOULD BE USEFUL TO CLARIFY, AND AT LEAST PARTIALLY REVISE, THE CONCEPT OF COORDINATED DIFFERENTIATED GROWTH AS OUT-  
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LINED IN PARA. 4, WHILE ATTEMPTING TO PUT SOME DISTANCE BETWEEN THE STRATEGY ENDORSED BY EPC AND THE POPULAR UNDERSTANDING OF THE "LOCOMOTIVE" THEORY. IT MAY BE POSSIBLE TO ADD IN THIS CONNECTION THAT THE DISCUSSION RESULTED IN A BETTER UNDERSTANDING OF INTRA-OECD RELATIONSHIPS WHICH WILL BE TAKEN INTO ACCOUNT BY NATIONAL GOVERNMENTS AS THEY FORMULATE ECONOMIC POLICIES THROUGHOUT 1978. THE EPC MIGHT ALSO CONCLUDE THAT A CLOSING OF THE RANKS BETWEEN EUROPEAN AND THE U.S. GROWTH RATES IS EXPECTED IN 1978, CREATING A BETTER CLIMATE FOR STABILITY IN THE EXCHANGE MARKETS. REVIEW OF NATIONAL OBJECTIVES CAN BE CITED AS HAVING RESULTED IN SOME MINOR ADJUSTMENTS OF INDIVIDUAL COUNTRY PROSPECTS, BUT THE AREA-WIDE PROSPECTS REMAIN AS IN THE DECEMBER "ECONOMIC OUTLOOK" (ASSUMING UNCHANGED POLICIES). FINALLY, A REFERENCE TO THE STRUCTURAL ADJUSTMENT DISCUSSION MAY BE IN ORDER. AS AT THE NOVEMBER EPC, THE PRIVATE SUMMARY OF THE CHAIRMAN WOULD MAKE THE ABOVE POINTS IN A STRONGER WAY. THE SECRETARIAT HAS TOLD MISSION THAT THEY WILL PREPARE A SUGGESTED OUTLINE FOR THE PRIVATE SUMMARY TO BE AVAILABLE TO SCHULTZE ON ARRIVAL.

9. RESTRICTED BUREAU: APART FROM DISCUSSING OUTLINES OF PUBLIC AND PRIVATE SUMMARIES, THE SECRETARIAT HOPES THAT THE BUREAU WILL CONSIDER THE MACRO POLICY/EXCHANGE RATE INTERACTION DRAWING ON THE WP-3 SUMMARY, WITH PARTICULAR EMPHASIS ON THE NEED FOR COORDINATION OF GROWTH POLICY UNLESS COUNTRIES ARE WILLING TO ACCEPT FURTHER EXCHANGE RATE CHANGES. THE SECRETARIAT WOULD ALSO LIKE TO INDUCE A BUREAU DISCUSSION ON STRUCTURAL ADJUSTMENT AS OUTLINED IN PARA. 6. THE BUREAU WOULD, IF DESIRED, BE THE LOGICAL PLACE TO CONSIDER PLANS FOR WORK LEADING UP TO THE OECD MINISTERIAL AND POSSIBLY THE SUMMIT.  
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10. ELECTION OF OFFICERS: THE SECRETARIAT HAS CLEARED

THE ELECTION PROCEDURE AND OUTCOME WITH ALL DELEGATIONS  
AND THEREFORE ANTICIPATES NO SURPRISES. TIETMEYER WILL  
NOMINATE THE ENTIRE SLATE OF OFFICERS (I.E., EPC CHAIR-  
MAN - SCHULTZE, EPC VICE CHAIRMAN - WASS, WORKING PARTY  
CHAIRMEN SCHREINER - WP-2, MATSUKAWA - WP-3, AND SLATER  
- WP-4) WHICH WILL BE ELECTED UNANIMOUSLY. THE SECRE-  
TARY-GENERAL WILL BE IN THE CHAIR FOR THE ELECTIONS.  
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## Message Attributes

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